



Should You Buy Canadian Pacific Railway Limited Ahead of its Q1 Earnings Report?

Description

Canadian Pacific Railway Limited ([TSX:CP](#))([NYSE:CP](#)), one of the largest rail network operators in North America, has watched its stock rise over 2% in 2015, and it could rally much higher following the release of its first-quarter earnings results on April 21. Let's take a look at four of the most important factors to watch for in the report to determine if its stock represents a long-term investment opportunity today.

1. Earnings per share and revenue results versus expectations

It will be highly important for Canadian Pacific to report earnings per share and revenue results that meet or exceed the expectations of analysts. Here's a chart of what analysts currently expect the company to accomplish and its results in the same period a year ago.

Metric	Q1 2015 Expected	Q1 2014 Actual
Earnings Per Share	\$2.16	\$1.44
Revenue	\$1.66 billion	\$1.51 billion

Source: *Financial Times*

The estimates above call for Canadian Pacific's earnings per share to increase 50% and its revenue to increase 9.9% compared to the first quarter of fiscal 2014. If these estimates are accurate, it would be a major improvement over the 16.1% earnings per share growth and 0.9% revenue growth achieved in the year-ago period.

2. Improvement of the operating ratio

Keep an eye on Canadian Pacific's operating ratio and make sure it continues to show improvement. The operating ratio is a statistic that shows the efficiency of a company's financial management by comparing operating expenses to net sales. Simply stated, the smaller the operating ratio is, the greater the company's ability to generate profit if revenues were to decline.

In the first quarter of fiscal 2014, Canadian Pacific's reported operating ratio was 72%, but this fell all the way down to 64.7% in the fourth quarter, an all-time record for the company, and I think it can get even lower in the first quarter of fiscal 2015.

3. The amount of free cash generated

Watch for the total amount of free cash generated by Canadian Pacific in the first quarter, because free cash is what allows it to invest in its growth, pursue acquisitions, and enhance shareholder value by paying dividends and engaging in share-repurchase activity. The company generated \$725 million of free cash in fiscal 2014, so it would be ideal for it to set the pace to match or exceed this amount by generating \$181.25 million or more of free cash in the first quarter.

4. Full year outlook reaffirmation

Make sure Canadian Pacific reaffirms or raises, but does not lower, its full year outlook on fiscal 2015. This outlook, provided in its fourth-quarter report, calls for adjusted earnings per share growth of more than 25% and revenue growth in the range of 7-8% compared to fiscal 2014, and an operating ratio below 62%, an improvement of 270 basis points or more from fiscal 2014.

Is now the time to buy shares of Canadian Pacific Railway?

Canadian Pacific Railway is one of North America's leading rail network operators, and I think it is well positioned to meet or exceed analysts' first-quarter earnings and revenue expectations, while also reporting a record operating ratio, generating strong free cash flow, and reaffirming its full year outlook.

In addition, I think Canadian Pacific's stock represents an attractive long-term investment opportunity today. I think this because it trades at favourable forward valuations, including just 20.9 times fiscal 2015's estimated earnings per share of \$10.91 and only 17.9 times fiscal 2016's estimated earnings per share of \$12.78, both of which are very inexpensive compared to its five-year average price-to-earnings multiple of 25.2.

I think Canadian Pacific's stock could consistently command a fair multiple of at least 25, which would place its shares around \$272.75 by the conclusion of fiscal 2015 and around \$319.50 by the conclusion of fiscal 2016, representing upside of about 19.5% and 40%, respectively, from today's levels.

With all of this information in mind, I think Foolish investors should strongly consider beginning to scale in to long-term positions in Canadian Pacific Railway today.

CATEGORY

1. Investing

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1. NYSE:CP (Canadian Pacific Railway)
2. TSX:CP (Canadian Pacific Railway)

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